

## **Business tax round up**

**(Lecture B1161 – 22.36 minutes)**

### **Yacht chartering losses**

*Summary – The LLP intended to realise profits but the prospects of profits were so remote that the trade was not carried on on a commercial basis and loss relief was denied*

Roulette V2 Charters LLP was a yacht chartering business that had two partners, Trevor Silver and Robert Newsholme. It conducted its trade using only one yacht, a 65 foot Oyster named Roulette V2. Trevor Silver had personally bought the yacht from the manufacturer in September 2007 with the aid of a loan. He subsequently discharged the loan and contributed the yacht to the LLP as a capital contribution in July 2008, shortly after the formation.

To generate business, the LLP stated that they had produced a business plan, produced brochures and took advantage of promotional articles in various magazines. However, costs were high, especially the depreciation of the yacht, which meant that the business struggled to be profitable. During this period, Trevor Silver made periodic capital contributions to the LLP in order to fund the losses. The partnership actually made losses from 2008/09 until 2015/16, 100% of which were allocated to Trevor Silver. He claimed to set these losses against his general income under s64 ITA 2007.

HMRC refused the claims for 2011/12 to 2015/16 on the basis that the yachting trade was not being carried on commercially with a view to profit as the business had never made a profit.

#### *Decision*

The First Tier Tribunal concluded that the business was trading even though they had:

- Significantly overestimated the likely amount of charter income;
- Failed to take account of the yacht's depreciation, making the chances of making a profit extremely remote.

The First Tier Tribunal accepted that the yacht had been acquired to carry on what they believed would be a profitable chartering trade and not simply to use it for his own private purposes. Family did use the yacht but they paid market rate. However, it should have been clear that the charter income was never likely to cover the running expenses.

The Tribunal concluded that the trade was not carried on on a commercial basis (s 66 ITA 2007). The taxpayer's appeal was dismissed.

*Roulette V2 Charters LLP v HMRC (TC07331)*

## Buying and selling racehorses

*Summary – HMRC were entitled to raise discovery assessments denying the losses claimed as the taxpayer had failed to demonstrate that he was trading.*

David Cliff was self-employed as a tax consultant, providing his services to racehorse trainers, jockeys, breeders and others in the equine industry.

In addition, from 1 January 2008, he considered himself to be self employed as a “dealer in thoroughbreds” buying and selling shares in racehorses and in horse racing syndicates. He did not draw up a business plan or profit forecasts. He did not train horses and he took no part in the decisions to sell the horses.

He decided to stop treating his activity as a commercial venture as at 31 December 2012, after he had incurred losses of approximately £160,000 over the preceding five years. He claimed loss relief against his other income.

HMRC issued discovery assessments denying the loss relief. They claimed that he had deliberately described himself as a ‘dealer in thoroughbreds’, which was inaccurate.

### *Decision*

For an appeal which involves a claim for losses incurred, the Tribunal stated that there was a ‘startling lack of evidence’ to show that any losses had been incurred. As a tax consultant, he should have known what records should have been kept. The Tribunal concluded that the lack of evidence alone was sufficient to dismiss the appeal against the assessments and closure notices.

The First Tier Tribunal stated that a dealer is someone who buys and sells goods with the aim of making a profit. They concluded that David Cliff was not a “dealer in thoroughbreds” because he did not buy and sell horses, or make decisions as to which horses should be bought or sold, or when. He “bought shares in horses and in racing partnerships”.

Although not necessary, the Tribunal went on to consider whether David Cliff’s activities of buying and selling of shares in horses and racing partnerships could have been trading. S30 ITTOIA 2005 prevents shares in racehorses from being trading stock, so the Tribunal concluded that purchase and sale of shares in racehorses could not be a trade.

So David Cliff’s appeal failed on a number of levels:

- He failed to provide any documentary evidence of the trade losses he claimed;
- S30 ITTOIA 2005 prevents shares in racehorses from being trading stock so his activity could not be a trade;
- Lack of involvement with the horses, and lack of a business plan, also indicated that could not trading.

The Tribunal concluded that David Cliff’s description of his activities was deliberately inaccurate and the discovery assessment was valid.

*David Cliff v HMRC (TC07358)*

## Capital allowances in communal areas

*Summary - Expenditure on the common areas of houses in multiple occupation did not qualify for capital allowances as evidence supporting the expenditure relating to these areas was not supplied.*

Hora Tevfik had acquired three properties for his property business that he let as houses of multiple occupancy and had incurred expenditure on communal areas which he wished to claim capital allowances.

Mr Tevfik's SA return for 2011/12 was received by HMRC showing a £50,000 Annual Investment Allowance (AIA) claim as well as a claim for 10% 'wear and tear allowance'. There were no comments/additional entries in the white space of the Return. HMRC accepted the Return without enquiry.

In April 2015, during the course of an enquiry into Mr Tevfik's 2012/13, HMRC discovered that his £50,000 AIA claim for 2011/12, related to expenditure on residential properties that were used in his property business which were let by him as houses of multiple occupancy. He had bought the properties from sellers who had not claimed any or all the capital allowances that might have been available, which therefore passed to him. He undertook a survey of the properties to identify qualifying expenditure, apportioning the purchase price for the property between plant and machinery and non-qualifying expenditure, having identified the communal parts and limited the claim to those parts. He did so on the assumption that such communal parts would not form part of a 'dwelling-house' and therefore would qualify as plant and machinery. No copy of the survey or specific identification of the communal parts was provided by him or his agent to the Tribunal.

On 17 August 2015, HMRC said that the AIA claim failed because AIA only applies to expenditure incurred on or after 6 April 2008 (s 38A CAA 2001). All of the expenditure was originally incurred before that date.

HMRC added that whilst he might have been able to claim plant and machinery allowances, the expenditure was not 'qualifying expenditure' as it was incurred in providing plant or machinery for use in a dwelling-house (s 35 CAA 2001). HMRC say that in an HMO, it is the totality of the property that forms the dwelling-house. It is the house as a whole that provides the facilities for day-to-day private domestic existence and hence the house as a whole that is the dwelling-house. The bedroom on its own; the kitchen on its own; the bathroom or hallways on their own do not provide the facilities, but together they are the dwelling-house.

Hora Tevfik argued that the expenditure was incurred on plant and machinery in the communal areas of the properties, which were not part of the 'dwelling-houses' and therefore capital allowances were due.

### *Decision*

The first issue was whether the discovery assessment was valid for the purpose of s29 TMA 1970. The First Tier Tribunal found that the existence of the wear and tear allowance claim in the 2011/12 return was not of itself sufficient to make HMRC aware that the annual investment allowance (AIA) claim would fail.

The First Tier Tribunal confirmed that the expenditure had been incurred before 6 April 2008 so that the AIA was not allowable but writing down allowances may be claimable.

The First Tier Tribunal stated that a communal kitchen and lounge are part of a dwelling-house. However, other 'common parts' of the building are not. These include the entrance lobby, corridors, stairs or lifts and those parts of the building which do not provide any living facilities. Neither would installations to the building such as mains, gas or electrical services, nor security and communication systems.

From the information provided, the expenditure was incurred in providing plant or machinery for use in a dwelling-house and related to common parts, communal or shared areas or installations in the properties. Such expenditure would be allowed by s35(3) CAA 2001 insofar as it is an asset provided partly for use in a dwelling-house and partly for other purposes but only so far as is just and reasonable. That meant that some of the expenditure incurred was allowed by s 35(3). However, Mr Tevfik had not identified these areas so that his claim failed.

*Hora Tevfik v HMRC (TC07383)*

## **Pre-incorporation legal fees**

*Summary - VAT could be claimed on legal fees invoiced to the director of a company that was incorporated after the legal services had been supplied.*

Mr McKee is a skilled software programmer who used to work for Jumar Solutions Ltd. While working there, he developed software in his spare time, that was unrelated to his work at Jumar, and that he intended to commercialise once he had left Jumar.

In January 2015, Mr McKee contacted a competitor of Jumar Solution Ltd, in the hope of gaining some materials that might assist with the development of his software. Jumar Solutions Ltd came to believe that he was seeking to develop a product that infringed Jumar Solution Ltd's copyright and confidential information that Mr McKee had acquired while working for Jumar. The company issued proceedings against Mr McKee for infringement of copyright, breach of confidence and breach of contract, seeking damages and an injunction.

Mr McKee successfully defended these proceedings arguing that had he not defended his position, he would not have been able to develop a business using his software. He delayed starting his business until after the judgment in case he lost the case.

Having successfully defended his case, on 8 July 2016, he incorporated Koolmove Ltd to exploit his software. Although Mr McKee had paid for the legal fees himself, he subsequently put them through his new company's books, showing in a director's loan account. He then sought to reclaim £28,876 on pre-incorporation legal fees.

HMRC denied the claim arguing that Koolmove Ltd was not incorporated at the time that the legal proceedings were instigated and the engagement letter between Mr McKee and his solicitors do not mention the company, therefore the legal costs were provided to Mr McKee in his personal capacity as the company did not exist at the time of the litigation.

The company appealed.

## *Decision*

The First Tier Tribunal confirmed that under the rules set out in the VAT Regulations 1995, reg 111, input tax can be claimed by a company in respect of supplies of services made prior to its date of incorporation for its benefit provided the:

- supplies were made to a non taxable person who became a member or officer of the company once the incorporation had taken place;
- company pays for the expenses in question;
- services supplied were made within six months before registration;
- services have a direct link to future taxable supplies made by the company.

The Tribunal stated that if HMRC insisted that input VAT could only be recovered if invoices were made out to the VAT registered business, then no pre-incorporation input tax claim would ever succeed.

The Tribunal found that Mr McKee had always intended to exploit his software through a limited company and that he incorporated the company as soon as reasonably practicable after the Jumar Solutions Ltd litigation was concluded in his favour. There was no point in him forming a company until he had won his case as he would have no business. Koolmove Ltd was formed and its future supplies were linked to the exploitation of the software developed by McKee.

The input tax on pre-incorporation legal fees could be claimed and the appeal was allowed.

*Koolmove Ltd v HMRC (TC07305)*

## **One business or two?**

*Summary – A café and restaurant run by husband and wife were separate businesses for VAT with both trading under the registration threshold as there was a clear intention on the part of the owners to run separate entities*

Charles Caton had run the Commonwealth Cafe for a number of years. In 2009, his wife opened a restaurant in adjoining premises. Both traded below the VAT registration threshold.

There were a number of factors that pointed to the idea that both businesses were run by Charles Caton:

- The lease for the restaurant, liability insurance, its alcohol licence and its bank account were all in Charles Caton's name.
- Initially the businesses operations did not share common areas but 2014 alterations were made to the premises, paid for by Charles Caton, to allow access to the toilets from both the café and the restaurant;
- In 2015 Charles Caton responded to an HMRC questionnaire reporting himself as the sole proprietor of the restaurant business and his wife as an employee;

- There were reviews of both the cafe and the restaurant on TripAdvisor that were responded to by Mr Caton, calling himself the owner;
- The website for the restaurant and the cafe suggested that they are one business;

HMRC claimed that Charles Caton was the owner of both businesses and should have registered for VAT from 1 December 2009 because the combined turnover exceeded the VAT threshold.

Charles Caton claimed that they were separate businesses with the cafe run by him and the restaurant run by his.

### *Decision*

The First Tier Tribunal found in favour of Charles Caton stating that there was a clear intention on the part of the owners to run separate entities.

- Staff were hired separately with his wife hiring her own staff;
- Mrs Caton decided on the menu for the restaurant as well as the prices;
- The cooking was done by different people using separate cooking areas;
- When the cafe sold the restaurant 'specials' they are rung up on the till with a marker that showed they were restaurant sales;
- Mrs Caton kept the cash generated from the sales in the cafe, which was not banked in Charles' account;
- Card sales were banked in Charles bank account but, Mrs Caton would transfer cash to cover her rent, rates etc, and she kept any surplus.

It was clear that the HMRC form was not filled in as diligently as it could have been. The TripAdvisor reviews replied to by Charles Caton were in 2016 when all parties agreed that Mrs Caton's English was not very strong and in both reviews the customers clearly identified Mrs Caton as the main figure in the restaurant.

The Tribunal noted that all the leases, insurance and the alcohol licence were in Charles Caton's name, and his bank account alone was used for the card takings. As Mrs Caton was not a British citizen, there were considerably more hurdles to her being able to obtain these items. In addition, with the parties being husband and wife, fully arm's length terms are not expected.

The Tribunal concluded that the facts that pointed to the businesses being run and owned as two separate operations were significantly stronger than facts that pointed to a joint ownership. In addition, without speaking to, Mrs Caton, HMRC could not be in possession of the full facts on which to base their decision.

The appeal was allowed and penalty is quashed.

*Charles John Caton v HMRC (TC07343)*

## Cosmetic or medical treatment

*Summary – Neither the injectable nor nail fungal treatments qualified as exempt supplies but for different reasons.*

Skin Rich Limited operated a skin culture and aesthetics clinic in Richmond offering a range of specialist skin treatments, including acne and rosacea treatment, non-surgical facelifts, nail fungus treatment, tattoo removal, skin peels and Injectable treatments. This case concerned the VAT treatment of botox and nail fungal treatment by the clinic.

HMRC identified that the turnover declared on the company's corporation tax return was greater than the supplies recorded on their VAT returns. On investigation it was discovered that the reason for the difference was because the company had failed to include what it considered to be exempt supplies in Box 6 of its returns. Having discovered this error, HMRC became interested in the treatments that were being accounted for as exempt medical supplies.

HMRC argued that botox and nail fungus treatment could not be considered as exempt as they are not medical treatments. HMRC argued that these services were standard-rated because clients sought treatment principally for cosmetic reasons.

Skin Rich Limited argued that both treatments were exempt treatments:

- Botox is a medical procedure with treatments enhancing self-confidence and influencing quality of life. Skin Rich Limited employed members of the medical profession to administer and supervise this treatment in all instances;
- Nail fungus treatment is a medical treatment as it is carried out to restore the health of the person concerned as GPs now advise their patients to seek private practices as the NHS is over-stretched.

To be exempt the procedures needed to fall under Group 7 Schedule 9 VATA 1994 and so to qualify a medical service or treatment supplied must be carried out:

- by a registered health professional;
- in the field for which the professional is registered.

In addition the treatment must be linked to the protection, maintenance or restoration of a patient's health.

### *Decision*

Having considered the evidence supplied, the First Tier Tribunal concluded that Skin Rich Limited had not satisfied them that the principal purpose of the botox or injectable treatments was to protect, restore or maintain the health of the individual rather than for cosmetic reasons. The treatment should be standard rated.

As for the nail fungal treatment this too did not qualify for exemption but for a different reason. This treatment was carried out using a medical laser process to kill the fungus but the person performing the work was not a registered medical professional.

An alternative argument put forward by Skin Rich Limited was that the premises used for the treatments was as a “hospital or state-regulated institution” (Item 4, Sch 9, Group 7, VATA1994) but this was also rejected by the Tribunal

The appeal was dismissed

*Skin Rich Ltd v HMRC (TC7310)*

## **VAT Notice 700/22 MTD for VAT**

Under MTD, subject to certain exemptions, VAT registered businesses must keep and preserve certain records and accounts, with some of these records kept digitally within functional compatible software

Data transfer between software programs, applications or products that make up functional compatible software must be digital where the information continues to form part of the digital records. This cannot be performed manually. Each piece of software must be digitally linked to other pieces of software to create the digital journey.

From the start, HMRC recognised the need for a “soft landing period”, for businesses to have in place digital links between all parts of their functional compatible software. For the first year businesses will not be required to have digital links between software programs. The VAT Notice stated that businesses have until their first period starting on or after 1 April 2020 (or 1 October 2020 for deferred businesses) to get these digital links in place.

However, on 17 October 2019, HMRC announced that some businesses may qualify for an extension to this initial soft-landing period. They have acknowledged that businesses with complex or legacy IT systems may require a longer period to put digital links in place across their functional compatible software. These businesses can apply for additional time to put the required digital links in place (subject to qualifying criteria). Even if the soft landing period is extended, it will only be by 12 months.

The VAT Notice specifically mentions the possible need for more time where another business has been acquired that uses different software applications or packages.

In an article “Making Tax Digital: More time for digital links?” that appeared in AccountingWEB, Emma Rawson highlighted a number of business areas using specialist or bespoke in-house software that may benefit from this extension. Specifically she mentioned veterinary practices as well as the hotel industry and universities.

### **Formal application**

To be considered for a specific direction, businesses will need to:

- make a formal application to HMRC for an extension by no later than the end of your soft-landing period;
- explain why it is unachievable and not reasonable for them to have digital links in place by April or October 2020;
- submit details of the systems that are unable to be digitally linked by providing a current map of existing VAT systems, highlighting the exact areas that cannot be digitally linked;

- provide a clear explanation and timetable for when and how digital links will be put in place within an extended period;
- state the controls that will be put in place to ensure any manually transferred data is moved accurately and without error.

HMRC will make their decision on a case-by-case basis, but it is worth noting that HMRC has indicated that they do not expect that any extension will ordinarily be more than a year.

*<https://www.gov.uk/government/publications/vat-notice-70022-making-tax-digital-for-vat/vat-notice-70022-making-tax-digital-for-vat>*